GRAY DRUG STORES, INC. 1966 ANNUAL REPORT

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CORPORATION FILE

Outstanding prescription service is our first objective at Gray Drug.

Attractive product display includes our own Gray-brand merchandise.

Trained specialists staff our large, bright, modern cosmetic departments.

New Rink's Department Store at Evendale, Ohio, developed $11,000,000 in sales at its own and at leased departments in its first full year.

ONE OF AMERICA'S LARGEST, MOST DIVERSIFIED DRUG CHAINS

Conventional Drug Stores

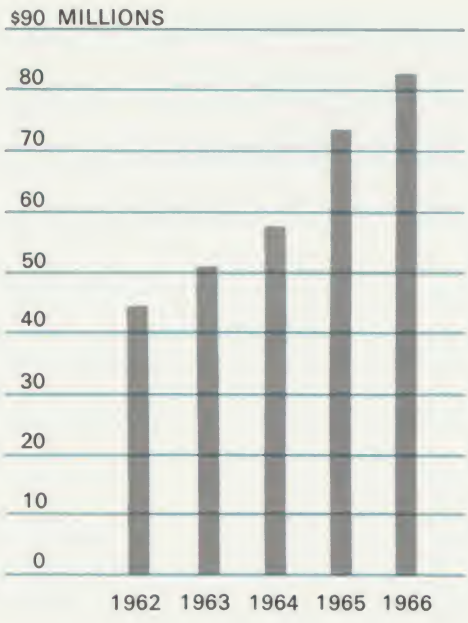
Discount Drug Stores

Prescription and Health and Beauty Aids Departments in Discount Department Stores

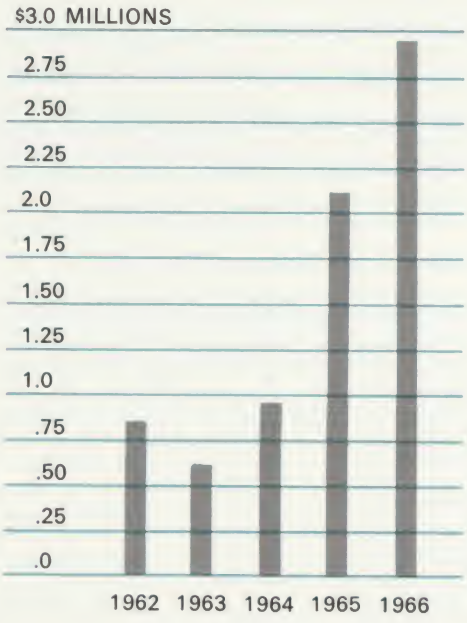
Rx Stores

Junior Department Stores

SALES



NET INCOME



HIGHLIGHTS OF OPERATIONS

Fiscal Years Ended June 30	1966	1965	1964
Net Sales	$83,352,705	$73,570,697	$57,320,337
Net Income	$ 2,912,432	$ 2,176,053	$ 946,404
Net Income Per Share	$ 3.36	$ 3.22	$ 1.50
Dividends Per Share	$ 1.10	$ .85	$ .80
Working Capital	$13,786,368	$12,431,574	$12,132,632
Current Ratio	2.19 to 1	2.21 to 1	2.77 to 1
Shareholders Equity	$20,045,091	$13,144,946	$10,783,652

173 STORES AND LEASED DEPARTMENTS

Years Ended June 30	New Stores and Leased Departments	Stores and Leased Departments Closed or Sold	Total Stores and Leased Departments	Stores Remodeled and Enlarged
1962	22	5	134	14
1963	28	10	152	13
1964	18	19	151	30
1965	25	18	158	39
1966	18	3	173	32

LETTER TO SHAREHOLDERS

MR. WEINBERGER

MR. EVANS

Gray Drug Stores, Inc., continued its long-term progress with new records in sales, net income and earnings per share from operations during the fiscal year ended June 30, 1966.

Sales of $83,352,705 were 13.3 per cent ahead of the preceding fiscal year. This was the 16th consecutive year in which volume increased.

Net income of $2,912,432 was 34 per cent higher than in the preceding year.

Earnings per share were $3.36. This compares with $2.51 a year ago on the basis of shares currently outstanding, and with $3.03 earned from operations during the preceding year on the smaller number of shares outstanding before conversion of our debentures. Based upon the average number of shares outstanding throughout the year ended June 30, 1966, the earnings per share were $3.87.

Financial Strength

For the first time in many years, we have no long-term debt whatsoever. Current assets at a record $25,452,557 were in a 2.19 ratio to current liabilities of $11,666,189 at the fiscal year-end. Shareholder equity as of June 30 was at an all-time high of $20,045,091.

Net income for the past year was equal to 3.49 per cent on sales, compared with 2.96 per cent a year ago.

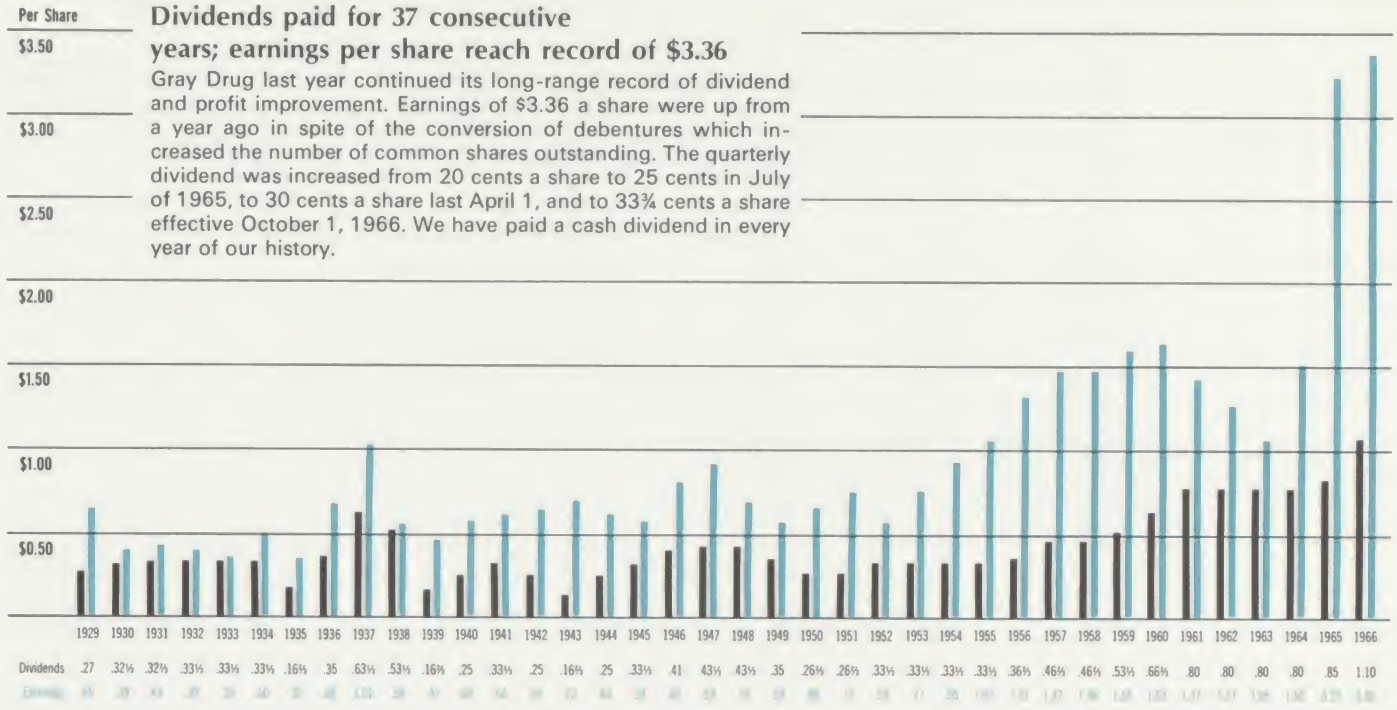
Our substantial cash generation, cash reserves, and increased borrowing power as a result of the conversion of debentures put us in a very strong financial position for internal growth and for possible acquisitions.

A Unique Pattern

Gray Drug is in not one business, but four. At the fiscal year-end, we were operating 114 conventional drug stores, 16 discount drug stores, 32 leased prescription and health and beauty aids departments in discount department stores, and seven large Rink's low-margin department stores. This diversity is unique for a drug chain. It provides us with four separate and distinct major fields for growth, and good progress is being made in each. In addition, we also operate leased soft goods departments in four other department stores.

Our total of 173 outlets at the fiscal year-end represents a net increase of 15 during the year. An even larger number of openings has already been scheduled for the current year.

Upgrading of our stores also is a constant endeavor. For example, we have closed 55 units and opened 111 new ones over the past five years, for a net gain of 56 . . . generally larger stores, in better locations. Large-scale remodeling was completed at another 128 stores, and smaller programs to take advantage of consumer buying trends by improving layout and decor are always under way in our stores.



Dividends paid for 37 consecutive years; earnings per share reach record of $3.36

Gray Drug last year continued its long-range record of dividend and profit improvement. Earnings of $3.36 a share were up from a year ago in spite of the conversion of debentures which increased the number of common shares outstanding. The quarterly dividend was increased from 20 cents a share to 25 cents in July of 1965, to 30 cents a share last April 1, and to 33¾ cents a share effective October 1, 1966. We have paid a cash dividend in every year of our history.

There are very few stores in our chain that are not newly opened or newly remodeled during the past five years.

Profit Trends and Planning

Increased consumer buying power and a strong economy have been important to our profit progress. Long-range planning and modern management techniques also are making a major contribution.

Concentration of our stores in the cities of Ohio and adjacent states provides for maximum impact from advertising expenditures, assures better warehousing efficiency than if stores were widely dispersed geographically, and permits close management controls.

Ours is a business involving millions of small consumer transactions a year, with as many as 25,000 different products and brands in a single drug store, and an operation of this nature puts a premium on modern profit control techniques. These will be further improved within the next few months through replacement of our present computer with a much faster and more sophisticated IBM 360 system.

A move into spacious new headquarters in downtown Cleveland has provided us with more efficient office facilities, and has enabled us to expand our central warehousing operation into the space previously used for offices. Also, Rink's is constructing a large new headquarters office and warehouse in Cincinnati, which will contribute to its efficient operation.

Three Dividend Increases

The Directors on August 22, 1966, recommended a 3 for 2 split of our shares, to be effective if approved by two-thirds of the shareholders at the Company's annual meeting to be held on September 30, 1966. The dividend, payable October 1, 1966, to shareholders of record on September 2, was raised to 33¾ cents per share. This is the third dividend improvement in slightly over a year, increasing the quarterly rate from 20 cents per share. The equivalent rate on new shares, if the split is approved, will be 22½ cents per share.

Gray Drug has paid a cash dividend for 37 consecutive years.

A Look Ahead

With sales per store increasing, and with new openings expected to add several million dollars to sales during the current year, we anticipate that volume will again set a new record.

We have made a number of acquisitions in the past, and we are in a better financial position than at any previous time in our history for making acquisitions. Exploring potential acquisitions both in the chain drug field and in the junior department store field will continue to be a major management objective.

As you read this report, you will find out more about many growth projects which we believe will enable us to maintain our long-range record of sales and profit progress.

Sincerely,

Adolph Weinberger, Chairman

C. W. Evans, President

September 9, 1966

GRAY DIVISION

Men's cosmetics, toiletries, greeting card and household goods departments in one of our newly remodeled stores are shown on this page. Also shown are Gray Drug cosmetic specialists at a training session.

CURRENT OPERATIONS AND GROWTH PLANNING

The Changing Consumer

Luxurious carpeting will soon be installed in the cosmetic departments of a number of our stores, beneath graceful chandeliers.

Bright colors specially developed by design consultants punch out the identification of prescription departments in newer stores.

Textured wall patterns with recessed or raised departmental signs featuring artist-designed lettering are another feature of new or remodeled stores.

Handsome entrance lobbies, spacious aisles for browsing, and decorator colors on the walls give our newer Rink's junior department stores the "look" and "feel" of stores in the high-price range.

All of these trends are in line with changing consumer buying habits in our affluent society. Consumers are more sophisticated. They seek competitive prices, but they are interested in product quality and real value rather than in price alone. Women in particular will spend more time today in a store that is a pleasant and attractive place, looking at the displays, and buying impulse items.

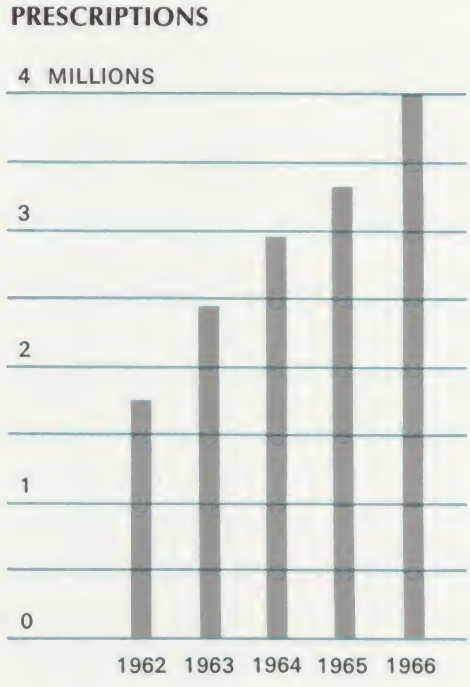
Gray Drug has kept pace with today's consumer, upgrading all stores to keep pace with consumer buying habits and desires. We believe this prestige image will continue to have a powerful impact on growth.

Prescription Leadership

The number of prescriptions filled in our pharmacies increased substantially during the past year, in line with historical trends.

Approximately 4,000,000 prescriptions were filled, an increase of 18 per cent over the preceding year.

Over 350 "men in white" staff our departments. Stocks are complete, to fit any prescription need, including those



Toiletries

Medicine Chest Items

Cough and Cold Remedies

Vitamins

OUR OWN BRAND NAME

Our good reputation with customers has led to outstanding success with a growing line of products provided under our own brand name. In just two years, we have introduced about 200 private label products, which accounted for about $1,000,000 in sales last year. All items are of high quality, and produced by leading manufacturers. However, elimination of national advertising costs and other expenses enables us to offer not only top quality but extra value as well . . . either by a lower price or by providing a larger quantity. At the same time, we can earn a more favorable profit. In addition to the product families shown here, we offer Gray-brand items ranging from baby needs to shaving supplies, from roll film to home remedies. And the list of such products is being constantly increased

Dental Hygiene

which are comparatively rare. Quality and service are simply the best we can provide, without compromise.

Adjacent to the prescription departments in a number of our stores we are opening new departments to provide convalescent supplies . . . wheelchairs, crutches, bedside equipment, for example. Initial response is good, and we believe these departments will grow rapidly as elderly consumers take advantage of Medicare benefits.

Rental of larger items is a part of our convalescent supply service, and may develop into a worthwhile source of income as the program grows.

114 Conventional Stores

Our Gray Division, operating 114 conventional drug stores, increased sales approximately eight per cent during the past year, to a total of about $46,000,000.

Five stores were opened by the Gray Division during the past year, four in shopping centers and one in a medical building. Two of these stores were in Cleveland, one in Youngstown, one in Cincinnati, and one in Buffalo, N. Y.

Major remodeling programs were completed at another 19 conventional drug stores, an important undertaking since we find that this work increases sales of a store from 10 to 20 per cent on the average as a result of improved presentation of merchandise and better traffic flow.

Opening of seven conventional drug stores is already on the schedule for the current year. Two of these will go into large mall-type shopping centers . . . at Midway Mall in Elyria, O., and Chapel Hill in Akron. These will be our most attractive stores yet, with a decor in which the merchandise blends with the general decorator treatment.

In addition, there will be sizable remodeling programs at 21 drug stores, plus additional upgrading of the cosmetic departments in other stores.

Our emphasis on large, attractive cosmetic departments with cosmetic specialists in each is resulting in excellent volume increases. We conduct regular regional meetings, in-store training, and an educational literature program for the women who staff our cosmetic departments, and there is a cosmetic demonstrator in each sales district.

Manufacturers of prestige toiletries and cosmetics now offer exclusive sales franchises to leading drug chains, and we are unique in our area in the number of top-level name brands we are able to offer women customers.

Men's toiletries, too, are enjoying a tremendous sales increase, and through providing of major display space and ability to obtain franchises from leading producers, we are benefitting fully from this trend.

Another new development is the providing of prestige candy departments. About 50 of our stores have been franchised as exclusive agencies for well-known candy lines in their particular territories, in line with our program of featuring better quality merchandise. This program is being expanded.

A few years ago, items selling for more than $10 were virtually unknown in our stores. Today, we offer small appliances, higher-priced perfumes and colognes, $15 pipes, cameras, and many similar higher-ticket items . . .

Over-all view of a recently acquired and remodeled Gray Division store.

KING DIVISION

Our discount units are large and attractive. Primary difference between discount drug units and conventional stores is that the number of products and package sizes is smaller, and hours are limited to peak consumer buying periods . . . reducing overhead expense and making it possible for us to sell at minimum prices.

along with an over-all price structure that we believe provides the best bargains in our area.

48 King Division Units

Our King Division, operating discount drug stores and leased prescription and health and beauty aids departments in discount department stores, increased sales 21 per cent last year, to a total of $22,198,000. Every unit but one gained in volume.

This division, just six years old, now includes 16 discount drug stores and 32 leased departments, including those in our own Rink's Department Stores. This is a net gain of nine units during the past year.

Rapid continuing growth is certain. By October 1, the King Division will be operating 56 discount units, or eight more than at the fiscal year-end, and five more complete leased drug departments are in the negotiation stage.

Our discount units also are constantly being upgraded, with one a month remodeled during the past year.

A discount drug store's profit potential becomes quickly apparent, and it usually operates under short-term lease, so that we are very flexible in this phase of our operations. We anticipate steady opening of a number of additional discount drug stores as the year progresses.

The King Division's other type of unit, leased departments in low-margin or discount department stores, also is proving very successful.

In addition to prescriptions, our larger leased departments often include complete cosmetic supplies, photo equipment, candy, office and school supplies, health products of all types, smoking supplies, greeting cards, and a wide range of sundries ranging from lunch kits and pet supplies to dyes and insecticides.

Prescription department in one of our King Division stores.

The King Division also operates our Superior Laboratories, Inc., a service unit principally responsible for photographic development of film turned in at all of our stores, for packaging of various products that we sell, and for the providing of battery and television and radio tube services and products offered to consumers by our retail units.

Superior Labs makes an important and growing profit contribution, and is expanding rapidly. The volume of color and black and white film developed at its plants in Cleveland and Columbus was up 35 per cent last year.

New color processing equipment and printers have been installed at the Cleveland plant, and the size of this facility will be doubled during the current year.

Rink's Department Stores

Rink's Department Stores contributed $15,000,000 to our sales during the past year, a gain of 15 per cent. In addition to this, another $19,000,000 in sales was developed in Rink's stores by operators of leased departments, so that combined total volume of Rink's and of leased departments in its stores was $34,000,000.

While the $19,000,000 in sales by leased departments at Rink's stores is not included in our reported volume, the

RINK'S DEPARTMENT STORES

Photos on this page illustrate a few of the 50 departments in Rink's giant new store at Bellevue, Ky., near Cincinnati. Shopping area in this store is larger than two football fields.

rentals from the operators of these departments, which are on a percentage of sales basis, add substantially to our net income.

Rink's is in the midst of a large expansion program. Work is starting on its new 80,000 square foot headquarters and distribution center in Cincinnati, which will triple the size of facilities presently available. This center will put Rink's in a position for continuing major growth.

At Bellevue, Ky., a Cincinnati suburb, Rink's recently opened its seventh unit, a new 100,000 square foot store . . . a modern, attractive retail giant involving a $2,000,000 investment in lessor's cost for land and buildings, and our own expense for fixtures and merchandise. This store will add an estimated $2,750,000 to our sales during the current year, with leased departments in the store accounting for another $7,000,000 in sales.

Among the 50 departments in the store are drugs, prescriptions, health and beauty aids, all provided by our King Division on a leased basis; plus clothing for the entire family, shoes, sporting goods, lawn and garden supplies, automotive products, housewares, home furnishings, and many other items. The store also features a leased grocery, complete with meat market, delicatessen, and bakery.

Rink's, with a policy of providing quality merchandise at low discount prices on a "satisfaction guaranteed or your money back" basis, has an outstanding reputation in the Cincinnati-Southern Ohio-Northern Kentucky area where its stores are located. It also operates leased soft goods departments in several other Ohio department stores, owned by outside interests.

Negotiations are completed for construction of another big 100,000 square foot Rink's store to be located in Middletown, Ohio. Also, the Hamilton Store is being expanded to include a prescription drug and health and beauty aids department to be operated by our King Division, which then will have leased departments in all Rink's stores.

A small section of one of our large Rink's stores.

We are actively seeking sites for construction of other Rink's stores, and anticipate continued rapid growth of this division.

A Successful Formula

As these reports on the operations of our individual divisions indicate, our Company has a specific formula for long-range growth and profit improvement, and it is working well.

The chain drug store and discount department store fields meet basic human shopping needs, and offer very real price advantages. These characteristics make our operations recession-resistant.

At the same time, our business is one in which the products of many of the nation's fastest growing industries reach the public . . . drugs, cosmetics, photo supplies, pocket books, greeting cards, for example. Our volume and profits immediately reflect increases in consumer buying power, and we are the principal drug chain in one of America's largest and fastest-growing industrial areas. Present stores are growing, and a total of 18 new units are already scheduled for this year, with several of them already in operation.

For these reasons, we anticipate that our long-range record of growth and profit progress offers a good guide to our outlook for the future.

CONSOLIDATED BALANCE SHEET Gray Drug Stores, Inc. and Subsidiaries

Assets	June 30, 1966	1965
Current Assets		
Cash	$ 2,259,669	$ 2,611,425
United States Treasury Bills — at cost plus accrued interest	2,959,871	2,721,263
Accounts receivable, less allowance of $30,000	684,651	531,572
Inventories — priced generally on the basis of the lower of cost (latest) or replacement market	19,164,777	16,443,691
Prepaid expenses	383,589	369,468
TOTAL CURRENT ASSETS	$25,452,557	$22,677,419
Other Assets	293,648	314,209
Property and Equipment — on the basis of cost		
Land (1966 — $159,982; 1965 — $158,219) and buildings	$ 255,627	$ 253,865
Furniture, fixtures and equipment	5,692,688	5,299,052
Leasehold improvements	2,863,450	2,735,080
	$ 8,811,765	$ 8,287,997
Less allowances for depreciation and amortization	4,038,682	3,691,610
	$ 4,773,083	$ 4,596,387
Good Will — Note A	1,191,992	812,262
Deferred Debenture Expense — Note B	—0—	131,814
	$31,711,280	$28,532,091

Notes to Financial Statements

Note A — Good will:

Good will at June 30, 1966, represents the excess of the cost of investment, to date, over the book value of capital stock of certain companies acquired in a prior year. Under the terms of the purchase agreement, the Company is making additional payments of the purchase price based on the annual net income of the acquired companies through June 30, 1968. Because there has been no diminution in the value attributable to good will, the Company does not now intend to amortize such amount.

Note B — 5% Convertible Subordinated Debentures:

The Debentures were called for redemption and were redeemed or converted on or before March 14, 1966.

Note C — Long-Term Lease Commitments:

The Company and subsidiaries are lessees under a number of leases extending from one to twenty-five years. The annual aggregate minimum rental payable under such leases (many of which provide for additional rental if amounts based on specific percentages of sales exceed the minimum) amounted to approximately $2,528,000 at June 30, 1966.

Liabilities and Shareholders' Equity	June 30, 1966	1965
Current Liabilities		
Trade accounts	$ 6,555,947	$ 5,663,848
Other liabilities and accrued expenses	2,225,727	2,283,440
Taxes other than federal income taxes	506,546	425,626
Federal income taxes	2,377,969	1,872,931
TOTAL CURRENT LIABILITIES	$11,666,189	$10,245,845
5% Convertible Subordinated Debentures Due 1982 — Note B	—0—	5,141,300
Shareholders' Equity		
Common Stock, par value $1 a share: Authorized 1,000,000 shares Outstanding 866,688 shares (1965 — 675,554 shares)	$ 866,688	$ 675,554
Capital in excess of par value	9,253,149	4,597,765
Earnings retained for use in the business	9,925,254	7,871,627
TOTAL SHAREHOLDERS' EQUITY	$20,045,091	$13,144,946
Long-Term Lease Commitments — Note C		
	$31,711,280	$28,532,091

See notes to financial statements.

Note D — Subsequent event:

Subsequent to June 30, 1966, the Board of Directors voted to recommend to the annual meeting of shareholders on September 30, 1966, an increase in the authorized amount of Common Stock from 1,000,000 to 2,000,000 shares, and a three-for-two stock split. The split would be effected by a transfer of $1 from capital in excess of par value to the Common Stock account for each additional share issued.

STATEMENT OF CONSOLIDATED INCOME AND EARNINGS RETAINED FOR USE IN THE BUSINESS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1966	1965
Net sales	$83,352,705	$73,570,697
Other operating income	205,930	195,296
Other income	107,617	243,939
	$83,666,252	$74,009,932
Costs and expenses:		
Cost of goods sold	$55,746,528	$49,482,246
Selling, general, and administrative expenses	21,158,782	19,035,839
Depreciation and amortization	967,289	869,409
Interest expense	212,621	284,785
	$78,085,220	$69,672,279
INCOME BEFORE FEDERAL INCOME TAXES	$ 5,581,032	$ 4,337,653
Federal income taxes	2,668,600	2,161,600
NET INCOME	$ 2,912,432	$ 2,176,053
Earnings retained for use in the business at beginning of year	7,871,627	6,264,215
	$10,784,059	$ 8,440,268
Cash dividends — $1.10 a share (1965 — $.85 a share)	858,805	568,641
EARNINGS RETAINED FOR USE IN THE BUSINESS AT END OF YEAR	$ 9,925,254	$ 7,871,627

See notes to financial statements.

SUMMARY OF CONSOLIDATED SOURCE AND APPLICATION OF FUNDS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1966	1965
SOURCE OF FUNDS		
From operations:		
Net income	$2,912,432	$2,176,053
Depreciation and amortization (including deferred debenture expense of $11,131 in 1966, and $7,948 in 1965) which did not involve working capital	978,420	877,357
TOTAL FROM OPERATIONS	$3,890,852	$3,053,410
Decrease — (increase) in other assets and miscellaneous	9,662	(226,579)
Proceeds from sale of Common Stock under option plan	—0—	258,882
Common Stock issued in connection with acquisition of certain companies	—0—	495,000
	$3,900,514	$3,580,713
APPLICATION OF FUNDS		
Expenditures for property and equipment	$1,143,985	$1,014,504
Principal amount of 5% Convertible Subordinated Debentures redeemed	163,200	—0—
Cash dividends declared	858,805	568,641
Additional good will purchased	379,730	812,262
Book value of property and equipment of companies acquired	—0—	886,364
Added to working capital	1,354,794	298,942
	$3,900,514	$3,580,713

STATEMENT OF CONSOLIDATED CAPITAL IN EXCESS OF PAR VALUE

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1966	1965
Balance at beginning of year	$4,597,765	$3,889,783
Excess of conversion price over par value of 191,134 shares of Common Stock issued upon conversion of $4,978,100 of 5% Convertible Subordinated Debentures due 1982, less expenses and cash paid in lieu of fractional shares	4,655,384	—0—
Excess of proceeds over aggregate par value of 15,900 shares of Common Stock sold under the Company's stock option plan	—0—	242,982
Excess of fair market value over aggregate par value of 30,000 shares of Common Stock issued in connection with acquisition of certain companies	—0—	465,000
Balance at end of year	$9,253,149	$4,597,765

See notes to financial statements.

ACCOUNTANTS' REPORT

Board of Directors
Gray Drug Stores, Inc.
Cleveland, Ohio

We have examined the consolidated balance sheet of Gray Drug Stores, Inc. and subsidiaries as of June 30, 1966, and the related statements of consolidated income and earnings retained for use in the business and of consolidated capital in excess of par value, and the summary of consolidated source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of income and earnings retained for use in the business and of capital in excess of par value present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1966, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. It is also our opinion that the accompanying summary of consolidated source and application of funds presents fairly the information therein shown.

Cleveland, Ohio
August 22, 1966

Ernst & Ernst

10 YEARS OF PROGRESS

	1966	1965	1964	1963	1962	1961	1960	1959	1958	1957
Net Sales	$83,352,705	$73,570,697	$57,320,337	$51,875,334	$44,952,417	$39,626,661	$37,552,700	$35,991,537	$32,249,706	$29,333,474
Net Income Before Federal Taxes on Income	$ 5,581,032	$ 4,337,653	$ 2,011,104	$ 1,399,066	$ 1,611,213	$ 1,467,793	$ 1,673,989	$ 1,607,591	$ 1,371,322	$ 1,404,880
Net Income	$ 2,912,432	$ 2,176,053	$ 946,404	$ 662,366	$ 801,113	$ 707,793	$ 793,989	$ 768,591	$ 692,322	$ 690,880
Income per Common Share (1)	$ 3.36	$ 3.22	$ 1.50	$ 1.05	$ 1.27	$ 1.42	$ 1.63	$ 1.58	$ 1.48	$ 1.47
Income as a Percentage of Sales	3.49%	2.96%	1.65%	1.28%	1.78%	1.78%	2.12%	2.14%	2.15%	2.36%
Income as a Percentage of Shareholders Equity	14.53%	16.55%	8.78%	6.41%	7.87%	9.04%	10 .82%	11.20%	11.06%	11.95%
Cash Dividends Declared — Common Stock	$ 858,805	$ 568,641	$ 503,723	$ 503,723	$ 476,335	$ 393,062	$ 323,850	$ 256,720	$ 218,718	$ 208,928
Dividends Per Share (1)	$ 1.10	$ .85	$ .80	$.80	$ .80	$ .80	$ .66⅔	$ .53⅓	$ .46⅔	$ .46⅔
Number of Shares Issued (1)	866,688	675,554	629,654	629,654	629,654	496,762	485,775	485,775	469,242	468,492
Net Working Capital	$13,786,368	$12,431,574	$12,132,632	$11,692,984	$11,599,620	$ 6,218,365	$ 6,087,245	$ 5,630,703	$ 3,691,958	$ 3,509,318
Total Assets	$31,711,280	$28,532,091	$22,764,138	$21,203,745	$20,296,698	$14,195,991	$14,114,536	$13,262,079	$11,195,293	$ 9,883,411
Long Term Debt	—0—	$ 5,141,300	$ 5,141,300	$ 5,230,000	$ 5,230,000	$ 2,139,200	$2,313,500	$ 2,313,500	$ 531,426	$ 576,377
Shareholders Equity	$20,045,091	$13,144,946	$10,783,652	$10,340,971	$10,182,328	$ 7,826,699	$ 7,338,099	$ 6,867,960	$ 6,259,195	$ 5,781,497
Book Value per Share (1)	$ 23.13	$ 19.46	$ 17.13	$ 16.42	$ 16.17	$ 15.76	$ 15.11	$ 14.14	$ 13.34	$ 12.34
Fixture and Leasehold Additions	$ 1,141,939	$ 1,184,347	$ 813,084	$ 923,337	$ 713,221	$ 901,411	$ 748,758	$ 985,427	$ 903,700	$ 786,314
Depreciation	$ 967,289	$ 869,409	$ 731,322	$ 758,985	$ 667,295	$ 663,750	$ 633,483	$ 575,139	$ 507,717	$ 465,372
Units in Operation — End of Year	173	158	151	152	134	117	111	107	102	86

(1) Based upon the number of shares outstanding at the end of each year adjusted to reflect a stock split of 3 for 1 on September 30, 1960.

STATEMENT OF CONSOLIDATED CAPITAL IN EXCESS OF PAR VALUE

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1966	1965
Balance at beginning of year	$4,597,765	$3,889,783
Excess of conversion price over par value of 191,134 shares of Common Stock issued upon conversion of $4,978,100 of 5% Convertible Subordinated Debentures due 1982, less expenses and cash paid in lieu of fractional shares	4,655,384	—0—
Excess of proceeds over aggregate par value of 15,900 shares of Common Stock sold under the Company's stock option plan	—0—	242,982
Excess of fair market value over aggregate par value of 30,000 shares of Common Stock issued in connection with acquisition of certain companies	—0—	465,000
Balance at end of year	$9,253,149	$4,597,765

See notes to financial statements.

ACCOUNTANTS' REPORT

Board of Directors
Gray Drug Stores, Inc.
Cleveland, Ohio

We have examined the consolidated balance sheet of Gray Drug Stores, Inc. and subsidiaries as of June 30, 1966, and the related statements of consolidated income and earnings retained for use in the business and of consolidated capital in excess of par value, and the summary of consolidated source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of income and earnings retained for use in the business and of capital in excess of par value present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1966, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. It is also our opinion that the accompanying summary of consolidated source and application of funds presents fairly the information therein shown.

Cleveland, Ohio
August 22, 1966

Ernst, Ernst

Liabilities and Shareholders' Equity	June 30, 1966	1965
Current Liabilities		
Trade accounts	$ 6,555,947	$ 5,663,848
Other liabilities and accrued expenses	2,225,727	2,283,440
Taxes other than federal income taxes	506,546	425,626
Federal income taxes	2,377,969	1,872,931
TOTAL CURRENT LIABILITIES	$11,666,189	$10,245,845
5% Convertible Subordinated Debentures Due 1982 — Note B	—0—	5,141,300
Shareholders' Equity		
Common Stock, par value $1 a share: Authorized 1,000,000 shares Outstanding 866,688 shares (1965 — 675,554 shares)	$ 866,688	$ 675,554
Capital in excess of par value	9,253,149	4,597,765
Earnings retained for use in the business	9,925,254	7,871,627
TOTAL SHAREHOLDERS' EQUITY	$20,045,091	$13,144,946
Long-Term Lease Commitments — Note C		
	$31,711,280	$28,532,091

See notes to financial statements.

Note D — Subsequent event:
Subsequent to June 30, 1966, the Board of Directors voted to recommend to the annual meeting of shareholders on September 30, 1966, an increase in the authorized amount of Common Stock from 1,000,000 to 2,000,000 shares, and a three-for-two stock split. The split would be effected by a transfer of $1 from capital in excess of par value to the Common Stock account for each additional share issued.

STATEMENT OF CONSOLIDATED INCOME AND EARNINGS RETAINED FOR USE IN THE BUSINESS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1966	1965
Net sales	$83,352,705	$73,570,697
Other operating income	205,930	195,296
Other income	107,617	243,939
	$83,666,252	$74,009,932
Costs and expenses:		
Cost of goods sold	$55,746,528	$49,482,246
Selling, general, and administrative expenses	21,158,782	19,035,839
Depreciation and amortization	967,289	869,409
Interest expense	212,621	284,785
	$78,085,220	$69,672,279
INCOME BEFORE FEDERAL INCOME TAXES	$ 5,581,032	$ 4,337,653
Federal income taxes	2,668,600	2,161,600
NET INCOME	$ 2,912,432	$ 2,176,053
Earnings retained for use in the business at beginning of year	7,871,627	6,264,215
	$10,784,059	$ 8,440,268
Cash dividends — $1.10 a share (1965 — $.85 a share)	858,805	568,641
EARNINGS RETAINED FOR USE IN THE BUSINESS AT END OF YEAR	$ 9,925,254	$ 7,871,627

See notes to financial statements.

SUMMARY OF CONSOLIDATED SOURCE AND APPLICATION OF FUNDS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1966	1965
SOURCE OF FUNDS		
From operations:		
Net income	$2,912,432	$2,176,053
Depreciation and amortization (including deferred debenture expense of $11,131 in 1966, and $7,948 in 1965) which did not involve working capital	978,420	877,357
TOTAL FROM OPERATIONS	$3,890,852	$3,053,41
Decrease — (increase) in other assets and miscellaneous	9,662	(226,57
Proceeds from sale of Common Stock under option plan	—0—	258,8
Common Stock issued in connection with acquisition of certain companies	—0—	495,(
	$3,900,514	$3,580,
APPLICATION OF FUNDS		
Expenditures for property and equipment	$1,143,985	$1,01
Principal amount of 5% Convertible Subordinated Debentures redeemed	163,200	5
Cash dividends declared	858,805	8
Additional good will purchased	379,730	
Book value of property and equipment of companies acquired	—0—	
Added to working capital	1,354,794	$3
	$3,900,514	

10 YEARS OF PROGRESS

	1966	1965	1964	1963	1962	1961	1960	1959	1958	1957
Net Sales	**$83,352,705**	$73,570,697	$57,320,337	$51,875,334	$44,952,417	$39,626,661	$37,552,700	$35,991,537	$32,249,706	$29,333,474
Net Income Before Federal Taxes on Income	**$ 5,581,032**	$ 4,337,653	$ 2,011,104	$ 1,399,066	$ 1,611,213	$ 1,467,793	$ 1,673,989	$ 1,607,591	$ 1,371,322	$ 1,404,880
Net Income	**$ 2,912,432**	$ 2,176,053	$ 946,404	$ 662,366	$ 801,113	$ 707,793	$ 793,989	$ 768,591	$ 692,322	$ 690,880
Income per Common Share (1)	**$ 3.36**	$ 3.22	$ 1.50	$ 1.05	$ 1.27	$ 1.42	$ 1.63	$ 1.58	$ 1.48	$ 1.47
Income as a Percentage of Sales	**3.49%**	2.96%	1.65%	1.28%	1.78%	1.78%	2.12%	2.14%	2.15%	2.36%
Income as a Percentage of Shareholders Equity	**14.53%**	16.55%	8.78%	6.41%	7.87%	9.04%	10 .82%	11.20%	11.06%	11.95%
Cash Dividends Declared — Common Stock	**$ 858,805**	$ 568,641	$ 503,723	$ 503,723	$ 476,335	$ 393,062	$ 323,850	$ 256,720	$ 218,718	$ 208,928
Dividends Per Share (1)	**$ 1.10**	$ .85	$ .80	$.80	$ .80	$ .80	$ .66⅔	$ .53⅓	$ .46⅔	$ .46⅔
Number of Shares Issued (1)	**866,688**	675,554	629,654	629,654	629,654	496,762	485,775	485,775	469,242	468,492
Net Working Capital	**$13,786,368**	$12,431,574	$12,132,632	$11,692,984	$11,599,620	$ 6,218,365	$ 6,087,245	$ 5,630,703	$ 3,691,958	$ 3,509,318
Total Assets	**$31,711,280**	$28,532,091	$22,764,138	$21,203,745	$20,296,698	$14,195,991	$14,114,536	$13,262,079	$11,195,293	$ 9,883,411
Long Term Debt	**—0—**	$ 5,141,300	$ 5,141,300	$ 5,230,000	$ 5,230,000	$ 2,139,200	$2,313,500	$ 2,313,500	$ 531,426	$ 576,377
Shareholders Equity	**$20,045,091**	$13,144,946	$10,783,652	$10,340,971	$10,182,328	$ 7,826,699	$ 7,338,099	$ 6,867,960	$ 6,259,195	$ 5,781,497
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BOARD OF DIRECTORS

LLOYD C. DOUGLASS
Vice-President
Gray Drug Stores, Inc.

CARLYLE W. EVANS
President
Gray Drug Stores, Inc.

HENRY H. GRAY
Vice-President
Gray Drug Stores, Inc.

MARVIN L. KAHN
Vice-President
Gray Drug Stores, Inc.

C. BERT MCDONALD
Partner
McDonald & Company

GEORGE F. KARCH
President
The Cleveland Trust Company

JOHN W. REAVIS
Partner, Jones, Day,
Cockley & Reavis

ADOLPH WEINBERGER
Chairman of the Board
Gray Drug Stores, Inc.

CARL WEINBERGER
Buyer
Gray Drug Stores, Inc.

JEROME WEINBERGER
Executive Vice-President
Gray Drug Stores, Inc.

OFFICERS

ADOLPH WEINBERGER
Chairman of the Board

CARLYLE W. EVANS
President

JEROME WEINBERGER
Executive Vice President

LLOYD C. DOUGLASS
Vice-President

HERBERT H. DURR
Vice-President

HENRY H. GRAY
Vice-President

MARVIN L. KAHN
Vice-President

LOUIS BERWITT
Secretary

ROBERT E. BREIG
Treasurer

JOSEPH VALINS
Assistant Secretary

KENNETH FREY
Assistant Treasurer

HYMAN ULLNER
President
Rink's Department Stores, Inc.

I. ROSEN
President
Superior Laboratories, Inc.

TRANSFER AGENT AND REGISTRAR

THE CLEVELAND TRUST COMPANY
Cleveland, Ohio

AUDITORS

ERNST & ERNST
Cleveland, Ohio

STOCK LISTED

MIDWEST STOCK EXCHANGE
Chicago, Illinois

COUNSEL

JONES, DAY, COCKLEY and REAVIS
Cleveland, Ohio

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WAREHOUSE

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